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CITATIONS

275785—40——1

In the Supreme Court of the United States

October Term, 1940

No. 551

Anna L. Raymond, petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 104) is reported in 40 B. T. A. 244. The opinion of the Circuit Court of Appeals (R. 147) is reported in 114 F. (2d) 140.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 22, 1940. (R. 153.) A petition for rehearing was denied on August 9, 1940. (R. 175.) The petition for a writ of certiorari was filed on November 4, 1940. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The petitioner, when over 70 years of age, transferred securities to several charitable institutions, which agreed to pay her annuities amounting to approximately 5 percent of the market value of the securities. Petitioner could have purchased similar annuities from an insurance company for less than one-half of the amount which she transferred to the charities. The questions are:

(1) Whether Section 22 (b) (2) of the Revenue Act of 1934 applies to annuities purchased from charitable institutions, and, if so, whether it applies to annuities purchased prior to the enactment of that Act.

(2) If Section 22 (b) (2) is applicable, whether it violates the Fifth or Sixteenth Amendments to the Constitution.

(3) If Section 22 (b) (2) is applicable and valid, whether the "consideration paid" for the annuities, within the meaning of Section 22 (b) (2), is the entire amount transferred to the charitable institutions, or only the amount for which petitioner could have purchased similar annuities from an insurance company.

STATUTE AND REGULATIONS INVOLVED

The statute and Regulations involved will be found in the Appendix, *infra*, pp. 12–15.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 105–106, 121–128) may be summarized as follows:

The taxpayer, when over 70 years of age, transferred securities having a fair market value of $1,246,906.76 to six charitable and educational institutions. The transfers were made pursuant to nine different contracts, each of which provided that the institution would pay the taxpayer a fixed annuity; in each case the annuity amounted to approximately five percent of the value of the securities transferred. The taxpayer was interested in the work and services of each of the institutions and intended by the contracts to benefit them as well as to acquire annuities. From time to time she had made outright contributions to these institutions aggregating over $400,000 and she had also contributed over $300,000 to similar institutions and community funds. (R. 105–106.)

Under the nine contracts, the taxpayer received annuities aggregating $62,500. She could have purchased annuities of this amount from any one of five large insurance companies for less than half of the value of the securities transferred by her. The prices at which such annuities could have been purchased, the value of the property transferred to the institutions, and the aggregate amount of the annuities received by the taxpayer are set forth in the Board's findings. (R. 105–106.)

In filing her income tax return for the year 1934, the taxpayer omitted from gross income the annuities received by her during that year on the theory that she had not yet recovered her capital. The Commissioner, however, determined that only part of the value of the securities transferred was the "consideration paid" for the annuities, within the meaning of Section 22 (b) of the Revenue Act of 1934, and that since the amounts received by the taxpayer aggregated more than the consideration paid, as he computed it, the excess was taxable gain (R. 107). He assessed a deficiency accordingly (R. 14–19).

The Board agreed with the Commissioner's determination that only a part of the amount transferred by petitioner was the consideration paid for the annuities. It held that petitioner could have purchased all of the annuities from an insurance company for $528,745.52, and that this should be considered the "consideration paid" within the meaning of Section 22 (b) (2) (R. 111, 119). Since the aggregate payments received by petitioner under the first seven agreements exceeded the "consideration paid", computed on this basis, the Board included in petitioner's gross income the amount of such excess (R. 106, 111, 119). With respect to the last two agreements, the aggregate payments received were less than the "consideration paid" computed on the basis of insurance company costs (R. 106); consequently, pursuant to the provisions of Section 22 (b), the Board included in petition-

(2)

er's gross income three per cent of the consideration paid for these annuities, computed on the basis of insurance company costs (R. 111, 119). The total amount of the annuity payments held taxable by the Board for 1934 was $28,138.66, and a deficiency in income tax for the year 1934 of $2,162.08 was determined (R. 120). The court below affirmed (R. 153).

ARGUMENT

Section 22 (b) (2) of the Revenue Act of 1934 provides a special scheme for the taxation of annuity payments. Any payments in excess of three percent of the "consideration paid" for the annuity is excluded from gross income until the aggregate amount so excluded equals the aggregate consideration paid. Thereafter the total amount of the annuity payments is included in gross income. The questions here are (1) whether Section 22 (b) (2) applies to the annuity payments received by petitioner; (2) if so, whether Section 22 (b) (2) is constitutional; and (3) if Section 22 (b) (2) is applicable and valid, whether the "consideration paid" for the annuities is all, or only a part, of the amounts transferred by petitioner to the institutions.

1. Petitioner urges that Section 22 (b) (2) is not applicable here because (a) the annuity contracts were made with charitable institutions, and (b) they were made prior to the enactment of the Revenue Act of 1934.

(a) The contention that Section 22 (b) (2) does not apply to annuity contracts made with charitable institutions is specious. The section speaks of "Amounts received as an annuity under an annuity * * * contract"; it draws no distinction between annuity payments made by a charitable institution and such payments made by other persons. The sole requirements for the application of the section are that the payment be received "as an annuity" and "under an annuity * * * contract"; those requirements are concededly met in the present case.

Petitioner's contention in this respect is based solely on a colloquy on the floor of the Senate between Senators Austin and Harrison (Pet. 27–28); in reply to a question by Senator Austin, Senator Harrison indicated that Section 22 (b) (2) does not apply to a taxpayer who purchases an annuity from a charitable institution. However, a reading of the next few lines of the Congressional Record shows that Senator Harrison, in giving the answer quoted by petitioner, had misunderstood Senator Austin's question, for he thereafter indicated an opposite view (78 Cong. Rec., Part 6, p. 5916).

(b) There is likewise no merit in petitioner's contention that Section 22 (b) (2) should be construed to apply only to annuities purchased after the enactment of the Revenue Act of 1934. The section contains no such provision and none can be read into its language. The authorities relied upon by the petitioner (Pet. 12) to the effect that estate

and gift taxes should not be given a retroactive effect are inapplicable; the tax here is not on an antecedent transfer but on income received after the Act became effective. Similar taxes have frequently been upheld by this Court over the objection that they were arbitrarily retroactive. See *Reinecke* v. *Smith*, 289 U. S. 172, 175; *Burnet* v. *Wells*, 289 U. S. 670, 682–683, and cases cited.

2. Petitioner's attack on the validity of Section 22 (b) (2) is likewise without merit. Its principal contention in this respect is that in any case where the beneficiary of an annuity contract has not received back annuity payments equalling the consideration paid for the contract, the requirement that a portion of the annuity payments (i. e., so much as is not in excess of three percent of the consideration paid for the contract) must be included in gross income imposes a direct tax upon capital rather than a tax upon income.

The argument is based on the fallacious premise that until the consideration paid for an annuity contract is recouped, all payments under the contract are a return of capital. This is plainly not the case. As pointed out in the House and Senate Committee Reports on the 1934 Act (*infra*, pp. 13–15), "Payments to annuitants are, in fact, based upon mortality tables which purport to reflect a rate of return sufficient to enable the annuitant to recover his cost and in addition thereto a low rate of return on his investment". Section 22 (b) (2) is designed to tax that portion of each annuity pay-

ment which does in fact constitute income. However, because it would be almost impossible to determine the precise amount of income which is included within any particular annuity payment, Congress fixed three percent of the cost of the annuity as the amount to be treated as income; it recognized that "While the percent used is arbitrary, it approximates the rate of return in the average annuity" (*infra*, p. 14).

None of the authorities cited by petitioner (Pet. 12–13, 31–37) throws any doubt upon the validity of the Congressional action in this respect. In *Burnet* v. *Logan,* 283 U. S. 404, upon which petitioner chiefly relies, the taxpayer had sold shares of stock in a company engaged in mining ore for cash and a royalty upon each ton of ore thereafter mined. The Court held that the taxpayer was not subject to income tax upon any of the royalties until they exceeded her cost basis. The case is clearly distinguishable, both because of the difference in the character of royalty and annuity payments and because the *Logan* case involved no statute corresponding to Section 22 (b) (2).

A much closer analogy to the present case is to be found in Section 44 (a) of the Revenue Act of 1934, which provides that any person who regularly sells personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when pay-

ment is completed bears to the total contract price. The vendor in the case of an installment sale, like the annuitant here, does not immediately recoup his capital and there is a possibility he may never recoup it. Yet the validity of the provision for treating a portion of each installment payment as income has never been questioned. Cf. *Pacific National Co.* v. *Welch,* 304 U. S. 191; *Nuckolls* v. *United States,* 76 F. (2d) 357 (C. C. A. 10th); *Lawler* v. *Commissioner,* 78 F. (2d) 567 (C. C. A. 9th).

3. If Section 22 (b) is applicable and valid, the judgment below is correct, irrespective of whether the "consideration paid", within the meaning of Section 22 (b), is the entire amount transferred by the taxpayer or, as the court below held, is only so much of that amount as would be necessary to buy comparable annuities from an insurance company. Under the decision below, the total amount of the annuity payments to be included in gross income for 1934 is $28,138.66. If, on the other hand, the entire amount transferred by the taxpayer to the institutions is to be treated as the "consideration paid", then three per cent of that amount, or approximately $37,000, is to be included in gross income. Consequently, even if petitioner were correct in its contention that the entire amount transferred should be deemed the "consideration paid", the decision of the Board was properly affirmed.

But in any event, we believe petitioner's contention to be plainly erroneous. As the Board

pointed out in its opinion (R. 108), the record establishes beyond question that the taxpayer was not interested solely in purchasing annuities; in the case of every transfer she intended to make a gift as well. If she had been interested simply in purchasing annuities, there were insurance companies readily available whose rates were substantially lower than the amounts which the taxpayer turned over to the charities. Yet the taxpayer made no investigation to ascertain how large an annuity she could have purchased for the amounts transferred but only as to how much each particular institution would pay her. At least one of the institutions involved characterized the transfer to it as a "most generous gift" (R. 122). The Board's conclusion is inescapable, therefore, that the transfers made were in part consideration for an annuity and in part a gift (R. 108).

Having reached this conclusion, the Board necessarily had to determine what portion of the amounts transferred were in consideration for the annuities. Since petitioner furnished no other proof on this question, the Board used as the criterion the cost of comparable annuities which could have been purchased from five large insurance companies. This criterion seems eminently fair and reasonable; taxpayer suggests no valid reason why the Board erred in adopting it, or, indeed, what other criterion the Board could or should have adopted. We believe it clear, therefore, that the court below correctly approved the Board's action.

CONCLUSION

The decision below is correct and is not in conflict with any decision of this Court or of any other circuit court of appeals. The petition for a writ of certiorari should, therefore, be denied.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.

NOVEMBER, 1940.